

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER



Natwar M. Gandhi
Chief Financial Officer

September 28, 2012

The Honorable Vincent C. Gray
Mayor of the District of Columbia
1350 Pennsylvania Avenue, NW – 6th Floor
Washington, DC 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
1350 Pennsylvania Avenue, NW – Suite 504
Washington, DC 20004

Re: September 2012 Revenue Estimate

Dear Mayor Gray and Chairman Mendelson:

This letter certifies, as of September 2012, revenue estimates for fiscal years 2012 through 2016. Revenue for FY 2012 is revised upward by \$139.5 million to reflect the stronger than expected revenue collections through August. The estimate remains unchanged for FY 2013 and beyond.

Despite the recent District job market strength and stronger than expected revenue, the continued uncertainty regarding post-election federal budget actions poses a real risk to the District's finances. A recent Congressional Budget Office (CBO) report predicts that the expiration of a variety of tax reductions at the end of the year, combined with the sequestration of federal expenditures (the so-called "fiscal cliff"), would push the already fragile national economy into a recession. This "double whammy" of federal expenditure cutbacks in the District and a national recession would almost certainly hurt the District's economy and finances. The extent of the impact on the District's economy and finances is difficult to quantify right now, so it is prudent to wait until we know how the Congress will resolve the long-term federal fiscal imbalance before changing the FY 2013 – FY 2016 estimate. If the federal government is able to address its fiscal situation in ways that do not adversely impact the District's economy, the revenue picture for the District would improve significantly from this forecast.

The table below compares the current revenue estimate to the previous estimate.

September 2012 Revenue Estimate Compared to Previous Estimate

	Estimate			Projected	
Local Source, General Fund Revenue Estimate (\$M)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
February 2012 Estimate	5,704.9	5,763.0	5,867.0	6,007.1	6,164.7
FY 2013 Budget changes	18.8	102.1	90.0	88.1	85.9
September 2012 Revisions to Estimate	139.5	-	-	-	-
September 2012 Estimate	5,863.2	5,865.1	5,957.0	6,095.2	6,250.6
<i>Percent change over previous year</i>	<i>8.7%</i>	<i>0.0%</i>	<i>1.6%</i>	<i>2.3%</i>	<i>2.5%</i>

Overview

Since the June revenue certification—which made no changes to the February certification—the District’s economic and fiscal prospects have strengthened despite a weakening national recovery. But a high degree of uncertainty still clouds the future course of the international, national and local economies. Federal cutbacks continue to pose the most serious threat to the District’s economic and fiscal outlook. The federal sequestration, if implemented in its current form, would have a severe impact on the District’s economy and finances. As noted above, the combination of the federal sequestration and the expiration of the Bush era tax cuts at the end of the year (the “fiscal cliff”) would likely to tip the national economy into a recession. Even if the Congress manages to craft a deal that avoids sequestration in its current form, such a deal could very well include reductions in federal spending, which could still hurt the District’s economy.

The possibility of federal government cutbacks and additional federal tax collections is not the only threat to the District’s economy. Key issues in the European debt crisis remain unresolved. The District’s economic prospects could also be hurt by disruptions to oil supplies from current Middle East instability and a downturn in the still fragile national economy, even if a “fiscal cliff” is avoided.

Revenue Highlights

The revenue estimate for FY 2012 is revised upward by \$139.5 million. Over the last three months tax collections have been buoyed by an estate tax windfall and stronger than expected growth in withholding and sales tax collections as jobs and wages in the District significantly improved (details are given below in the section on the District Economy). Higher than expected revenue from automated traffic enforcement also contributed to the strong revenue performance over the period. Of the almost \$140 million in additional revenue in FY 2012, roughly \$50 million is from an estate tax windfall. Another \$50 million is from higher than expected withholding tax collections, \$23 million from sales taxes, and \$23 million from automatic traffic enforcement. The higher revenue is offset somewhat by lower than expected deed and gross receipts taxes collections.

National and Regional Economies

The fundamentals underlying the national economy have weakened since the February estimate, and there are still significant uncertainties that weigh on the short to medium term outlook. After 12 consecutive quarters of fairly slow growth, the U.S. economy has technically entered an expansion period because the level of real GDP has surpassed the previous peak of June 2008.

- U.S. employment added about 1.8 million jobs (1.4 percent) from August 2011 to August 2012, but was still 4.7 million (3.4 percent) below the start of the recession. Falling public sector employment—federal, state and local—is now pulling down the numbers. Job growth in each of the past four months has been below that of December 2011, and January and February of 2012.
- The U.S. unemployment rate (seasonally adjusted) fell to 8.1 percent in August, down from 9.1 percent a year earlier.
- U.S. Personal Income in the June quarter was 3.3 percent above a year ago.
- The Standard & Poor 500 stock market index in August was 4.6 percent above its level three months ago, and 18.4 percent more than a year ago.
- In the past few months, regional gains in employment have increased. In the three-month period ending July, the region gained 34,067 (1.1 percent) wage and salary jobs compared to a year earlier; all the gain was in the private sector.
- The metropolitan area unemployment rate was 5.6 percent in July (not seasonally adjusted).

The District Economy

Since January 2012, the growth in wage and salary jobs located in the District has slowed, while resident employment began to accelerate.

- In July, there were 8,033 (1.1 percent) more wage and salary jobs located in the District than a year earlier, all in the private sector, as measured by the 3-month moving average. Of particular note, there were 3,500 (1.6 percent) fewer federal government jobs in July than there were a year earlier. Health services accounted for almost half of DC's net job growth over the past year.
- District resident employment in July was 15,729 (5.1 percent) more than a year earlier. The unemployment rate declined to 8.8 percent, down from 10.5% a year earlier.
- Wages earned in the District of Columbia grew 3.6 percent in the March 2012 quarter, compared to the same quarter a year ago. Personal Income was 4.9 percent higher.

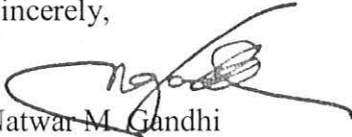
- Housing slowed in recent months. Single family sales for the three-month period ending August 2012 were down 0.5 percent from a year ago, and there was a 0.1 percent decrease in the average selling price.
- August condominium sales over the three-month period ending August were up 17.9 percent and the average price was 1.6 percent higher. The value of all home sale contracts for the August three-month period was 5.7 percent more than a year ago.
- In the quarter ending June 2012, occupied office space rose by 0.1 percent from the prior year and the commercial office vacancy rate rose to 9.2 percent (including sublet), still well below the metropolitan area average of 12.6 percent. An additional 3.0 million square feet are expected to be added to inventory over the next two years, and the District's vacancy rate is also expected to rise to 9.8 percent.
- Tourism has been mixed. For the three-month period ending July, the average room-rate for hotels declined 0.3 percent, while the number of hotel room-days sold was up 1.3 percent. Revenues from room sales were up 0.9 percent. For the three-month period ending July, employment in retail was up 0.7 percent, and there was growth in restaurant employment (up 2.1 percent) and accommodations (up 3.0 percent).
- Tax collections for fiscal year 2012 have been quite strong, with individual income, sales, and business taxes all showing significant growth.

Outlook and Risks

Although risks are present from the European debt situation and Middle East disruptions to world oil supplies, the primary concern at this time is federal government budget and tax decisions. Federal government expansion cushioned the District and the metropolitan area economies from the worst effects of the recession over the past four years. The federal government will no doubt continue to anchor the District's economy, but given the current budget scenarios, it can no longer be counted on to be a source of real growth. Although the current revenue estimate includes the impacts of federal sequestration and repeal of the Bush-era tax cuts, should the impact be greater than what we have assumed, the District's fiscal outlook would worsen. On the other hand, if the federal government is able to address its fiscal situation in ways that do not destabilize the District's economy or lead to a U.S. recession; the revenue picture for the District would improve substantially from that contained in this revenue letter. It is hoped that Congress will have taken steps to resolve the federal long term fiscal imbalance by the time of the next revenue estimate.

If you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,



Natwar M. Gandhi

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